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Central Intelligence Agency

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DIRECTORATE OF INTELLIGENCE

29 June 1983

LEBANON: Economic Impact of Partition

Summary

Under the very poor security conditions that exist now and would remain after a partial Israeli withdrawal, Lebanon's economy will continue to stagnate. Economic recovery remains tied to foreign troop withdrawal and the establishment of political and security conditions conducive to private-sector investment. [redacted] 25X1

Israel will continue to try to export its agricultural products to Beirut and route third-country goods to Lebanon via Israel's port of Haifa at the expense of Beirut's treasury and the farmers of the occupied south. We expect this to occur regardless of whether Israel partially pulls back its forces. The goals of Israel's economic penetration are to ensure that politically powerful groups in Beirut have a financial interest in maintaining close political and economic ties with Israel and to erode their resistance should Israel decide to prolong its occupation. [redacted] 25X1

As long as Syria remains committed to undermining the Gemayel government or Israel occupies a large chunk of Lebanese territory we do not believe that the Arab Gulf states will grant Lebanon significant financial assistance. The Saudis and other Arabs may impose a partial economic boycott of Lebanon if they believe Israeli-made goods are entering their markets through Lebanon. [redacted] 25X1

Gemayel will continue to press for US economic aid to finance large budget deficits and may appeal to the US to halt Israeli penetration of Lebanese markets. Unless a

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This memorandum was prepared by [redacted] *Arab-Israeli Division, Office of Near Eastern and South Asian Analysis, with a contribution from* [redacted] *Geography Division, Office of Global Issues. Information as of 27 June 1983 was used in preparation of this paper. Comments and queries are welcome and should be addressed to Chief, Arab-Israeli Division* [redacted] 25X1 25X1 25X1

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stable peace breaks out in Lebanon--an unlikely development--US aid may ameliorate living conditions in Beirut but will not start the ball rolling toward a general reconstruction. Domestic confidence in a safe and stable future is both the necessary and the sufficient condition for rapid economic revival in Lebanon. 25X1

Current Economic Situation*

Economic activity in Lebanon has remained low since the end of the fighting in September 1982 in contrast to past years, when the economy has rebounded during intervals of relative calm. Farming has probably been the hardest-hit sector. The summer's fighting in the south and in the Bekaa Valley--where agriculture is king--destroyed many crops in the fields and since then agriculture has remained depressed:

-- The continued presence of large Syrian and Israeli occupation armies in the fields has precluded normal farming operations.

-- The departure of many Egyptians, Syrians and Palestinians from the south since June 1982 has left farmers short of field labor.

-- Zahlah--the city in the Bekaa Valley that is farmers' major source of key agricultural supplies--is a Christian community surrounded by the Syrian army and Lebanese Moslems; travel in and out is dangerous. 25X1

Israeli farm goods have captured a substantial share of the Beirut market from the south's Shia farmers despite a public Israeli pledge in late 1982 that Israel would not export to Lebanon goods that competed with local products. President Gemayel's failure to stem the flow of Israeli produce into Beirut aggravates Shia suspicions that Gemayel cares little for their fate and would welcome the permanent partition of Lebanon. Trade with Israel has long been illegal under Lebanese law in accordance with the Arab economic boycott of Israel. 25X1

Exports have suffered as some Arab states briefly banned the import of some Lebanese goods earlier this year. The Arabs--including Saudi Arabia and Jordan--have claimed and Embassy reporting tends to corroborate that some Israeli products were mislabeled as Lebanese to evade the Arab boycott of Israel. 25X1

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* Our trade and national income statistics are estimates; Lebanon's Statistical Office closed down in 1975 and never reopened. 25X1

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Finally, travel on Lebanon's roads is hazardous and often impossible. The Israeli Defense Forces (IDF) frequently close the Sidon-Beirut road--the principal north-south route altogether. Truck travel over the Damascus-Beirut highway, the main farm export route, is also severely restricted by the various forces that control different segments. [redacted] 25X1

Lebanon's small industrial sector has taken a beating in eight years of recurring hostilities (see appendix). [redacted] 25X1 [redacted] 25X1 only two or three factories of Lebanon's once-flourishing textile industry still operate. Electricity transmission and distribution systems have been heavily damaged and power outages are frequent. The US-owned Medreco oil refinery in the south--one of Lebanon's two--suffered about $4 million worth of still-unrepaired damage in the 1982 fighting according to a company official, although it is still operational. [redacted] 25X1

Traffic at the principal Lebanese port of Beirut has dropped sharply in recent months. The port operators have confirmed to US officials that the reexport trade is down, demand for industrial imports is low, and seaborne exports are even more depressed. Many of the imports that are entering Lebanon come through Israel--Tel Aviv permits Lebanese to import goods duty-free via Israel's port of Haifa. The US Embassy estimates that roughly 35 large and medium size trucks leave the border each day carrying both Israeli exports and third-country goods from Haifa northward into Lebanon. [redacted] 25X1

A surge of optimism about Lebanon's political prospects after the arrival of the multinational peacekeeping force in September sparked a wave of rebuilding inside Beirut, particularly in the ravaged no-man's land known as the Centre Ville that has been largely uninhabited since the civil war. Most of the rebuilding, however, was either the minor repairs needed to make homes habitable and small businesses operational or limited to clearing away rubble to ready buildings for eventual major repairs. Few businessmen felt confident enough about the future to invest the major sums necessary to create new enterprises. [redacted] 25X1

The government's financial picture brightened somewhat early in 1983 although the deficit remains very high. Customs revenues rose after President Gemayel closed down several of the "illegal" ports operated by the principal Christian militia, the Lebanese Forces and directed ships to the government-controlled Port of Beirut. Similarly, the new perception in West Beirut after Gemayel took control there in February that the government was able to impose penalties for non-payment of taxes has boosted income tax receipts, according to the US Embassy. Nonetheless, Beirut's writ still runs only in a very small section of Lebanon, and it is unable to collect taxes or customs duties in areas under Syrian and Israeli control (see map). Customs duties

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continue to be evaded by the rerouting of Lebanese imports through Haifa. [redacted] 25X1

Expenditures have not fallen commensurately with the decline in the government's area of control. In a bid to retain the allegiance of the civil servants, the government has continued to keep them on the payroll even though most ministries have barely functioned for years and many employees show up only to pick up their paychecks. [redacted] 25X1

By contrast, Lebanon's foreign exchange indicators remain strong. Through eight years of turmoil, Lebanon has never come close to a balance-of-payments crisis. Although the Lebanese pound fell sharply in the four months immediately following the invasion, by October, the pound had regained almost all of the ground it had lost--rising sixteen percent at a time when most other currencies were declining against the dollar--and the Central Bank resorted to dumping pounds on the market to slow the pound's rapid rise. By February 1983, the pound was stronger than it had been since 1980. [redacted] 25X1

Official gold and foreign exchange holdings alone afford Lebanon well over a year's worth of import coverage. Primarily because of the speculative rise in the pound and continuing inflows of remittances, official foreign exchange reserves at the end of February 1983 totaled $2.3 billion. The government also holds 9.2 million ounces of gold--worth about $4 billion at current market prices. Local bankers agree that the private sector also has substantial liquid assets--both domestic and foreign--that could be mobilized to support reconstruction. Worker remittances, which compose about 40 percent of GNP and are by far Lebanon's largest foreign exchange earner, are reportedly holding steady. [redacted] 25X1

We believe Lebanon's banking sector remains fundamentally sound, although local bankers report that private-sector loan demand is currently virtually non-existent. The banks remained open even through the worst of the Israeli bombing of Beirut, and very little, if any, capital flight from Lebanon seems to have taken place since the war. [redacted] 25X1

Outlook

President Gemayel is immersed in his political and military problems and Embassy reporting has emphasized that economic revival is among the least of his concerns. He is unlikely to fund a major reconstruction program anytime soon and probably reasons, as do many of his finance officials and the private sector, that if and when political and security issues are successfully resolved, economic recovery will follow of its own accord. The remainder of this paper outlines the economic consequences of a variety of political/security developments, highlighting the impact of de facto partition. [redacted] 25X1

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Partial Israeli Withdrawal

It seems increasingly likely that as Syria continues to refuse to withdraw its forces Israel will unilaterally pull out of the mountain districts just south of Beirut and remain in the Bekaa and southern Lebanon indefinitely (see map). 25X1

We expect that the IDF, citing security problems, would expand its current restrictions on commmerce and agriculture that would keep the south's economy depressed. The US Embassy reports that merchants in Sidon--the major city in southern Lebanon--recently went on two general strikes to protest Israeli transportation restrictions and other perceived injustices. The strikes provoked a short-lived Israeli attempt to retaliate by closing the shops of some of the activists. 25X1

Antagonism toward other IDF moves will harden local anti-Israeli sentiment. In contrast to the IDF's frequent closures of the Sidon-Beirut road, the Embassy reports that the highway connecting Israel and Sidon is rarely blocked, leading many Lebanese to suspect that closures of the Beirut road are part of an Israeli campaign to force the south to direct its trade to Israel. The IDF also detains some Lebanese trucks carrying produce north to Beirut, frequently holding them in the hot sun until the produce is spoiled, according to the Embassy. 25X1

Local anger is heightened by a recent Lebanese press report that IDF will not permit any merchandise to enter Israeli-occupied areas from Beirut or elsewhere in Lebanon unless the Israeli military commander in Sidon has given prior approval. Moreover, earlier this year the head of the Chamber of Commerce in Sidon announced that he would begin to compile a list of Lebanese businessmen violating Lebanese law by trading with Israel. Shortly afterwards he was summoned to the headquarters of the Israeli military government and instructed to desist. 25X1

We believe the main goal of Israeli economic penetration--selling its own exports and promoting Haifa as an alternate import route--is to ensure that politically powerful groups in Lebanon have a financial interest in maintaining close political and economic ties with Israel and to erode their resistance to permanent trade relations. Israel probably recognizes that those segments of Lebanese society that profit from the Israeli moves--importers of manufactured goods and consumers in Beirut--are primarily politically influential Christians and Sunnis. By contrast, the farmers in the south who are suffering from the Israeli restrictions are mostly domestically powerless Shia. 25X1

Although some Christians and Sunnis still refuse to violate the Arab economic boycott by trading with Israel, we believe that this sentiment would decline over time, as the advantages of an Israeli connection--such as duty-free imports and inexpensive produce--become apparent, and the real costs of continued opposition--such as merchants' strikes--mount. Shia farmers in

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the south, however, would derive no financial advantages from the situation and would be unlikely to reconcile themselves soon to it. Virtually all the bilateral trade consists of Israeli exports to Lebanon, and while Israel might eventually extend some trade preferences to Lebanese wanting to export to Israel but these would probably be strictly limited. 25X1

If a partial Israeli withdrawal were perceived as a lasting partition, in which any renewed hostilities between Syria and Israel were unlikely to spread to Beirut, we believe Lebanese and foreign investors would follow much the same pattern in the Beirut area that they have since the onset of civil war in 1975; transit, service and tourist businesses would rebuild if it appeared to the perenially optimistic Lebanese that the Beirut government would be able to enforce peace and security in the territory under its nominal control. Similarly, the government might go ahead with more of the Beirut-area reconstruction projects drawn up by its Council for Development and Reconstruction (CDR). 25X1

We think it unlikely that Gemayel's army could secure the area left to his government without the continued presence of a sizable MNF contingent. If security were not assured, nervous entrepreneurs would continue to put off large-scale reinvestment, and low loan demand would likely force closure of a few of Beirut's many small banks, though the banking industry would not be seriously undermined. Lebanese and foreign confidence in the stability of the banking system continues to be high. The past eight years of intermittent warfare have not prompted major capital flight, and we do not believe that renewed violence is likely to do so. To replace private sector loan demand, the banks could continue to lend fairly large sums to the government and would probably seek international borrowers more aggressively. 25X1

Beirut would look to western donors such as the US and domestic borrowing to finance continued budget deficits. Domestic revenues would remain low since most of Lebanon would still be beyond the reach of Gemayel's taxmen and the depressed economy and competition from Haifa port would keep customs receipts low. Large-scale aid from the Gulf states would be unlikely to materialize, primarily because of the continued Israeli presence, but also because the Arabs are facing their own financial problems. Nor would the World Bank be likely to take the lead in financing reconstruction projects. Bank officials have already indicated that they would be very reluctant to do so unless the central government was in control of all Lebanese territory. 25X1

Critical balance-of-payments problems would be unlikely, however. Beirut's foreign debt is very low, and we doubt that the crucial inflow of remittances would decline. These funds are devoted mainly toward covering the living expenses of local relatives, and barring Beirut's complete and prolonged breakdown

into chaos, we do not believe that many expatriate Lebanese will move their families out of Lebanon. [redacted] 25X1

A Boycott?

It is possible that in response to a partition and expanded Israeli-Lebanese trade, Syrian President Assad would close Syria's borders and airspace to Lebanon. A complete shutdown would cut Lebanon's only overland transport route to the Gulf states--which buy the great bulk of Lebanon's exports--and force air traffic to detour over the Sinai. Such a move would make economic recovery harder, but would not deal a major blow to the economy as it stands today. If the economy did begin to recover and the security problems associated with travel eased, some of the additional export traffic could be rerouted through the port of Beirut and a smaller share could economically be sent out by air freight. [redacted] 25X1

We doubt that Damascus would close the border entirely; Lebanon is a choice route for smuggling into Syria, which Syrian officials have long tolerated and often directly profited from. Damascus would probably continue to permit cross-border trade from the towns and villages in northern Lebanon where Syria has substantial support. The Syrians would be more likely to turn back trucks carrying merchandise to or from Beirut, where Christians control much of the commerce. [redacted] 25X1

We think it unlikely that other Arabs would impose harsh economic sanctions. When Sadat signed the Camp David accords, the other Arabs did not take the critical steps of sending expatriate Egyptian workers home or banning Egyptian imports, and we do not believe they would take such drastic measures against Lebanon now. An Arab blacklist of Lebanese firms trading with Israel probably could not be enforced, especially in view of Lebanon's strict bank secrecy laws and Israeli efforts to protect the identity of their Lebanese trading partners. [redacted] 25X1

A simple Arab boycott of Lebanese commodity exports, such as was briefly imposed by Jordan and Saudi Arabia earlier this year, would be more likely. If one were imposed, agriculture would be hard-hit until other markets could be found. If the boycott also extended to third-country exports transiting Lebanon on their way to the Gulf, the transportation sector and government port revenues would be severely hurt. [redacted] 25X1

No Withdrawal of Forces

If Israel, Syria, and the PLO do not withdraw from their current positions, we expect continued military tension and sporadic outbreaks of violence that could escalate into major Syrian-Israeli hostilities. Economic activity would remain depressed throughout the country. Major investment in Beirut, the south, and the Bekaa Valley would be deferred as the private sector's fear of further fighting would make it unlikely that

[redacted] 25X1

entrepreneurs would risk their funds in building new plants, although some small-scale rebuilding would continue. The south's economy would continue to suffer from such anti-Israeli protests as merchants' strikes and additional IDF restrictions on commerce. [redacted] 25X1

What About War?

In the event of a Syrian-Israeli war, the business community would abandon any hope of rebuilding until the shooting stopped and the outlines of Lebanon's new political order emerged. Fighting and troop movements would bring agriculture as well as most other activity in the south and the Bekaa to a halt. The Medreco refinery near Sidon would probably suffer major additional damage--as it did in 1978 and 1982. If so, Medreco would abandon the refinery, according to a company official. [redacted] 25X1

Closure of Medreco would leave Lebanon with just one operational refinery--in Syrian-controlled Tripoli. Both of its pipelines are already closed. Although Lebanon could import all the fuel it needs via the ports of Beirut, Tripoli, and Sidon, we believe the dangers and restrictions associated with travel in another war would seriously disrupt supplies to essential businesses such as hospitals and bakeries. [redacted] 25X1

In the event of another war, the owner of Lebanon's freight airline, Trans Mediterranean Airways (TMA), has told US officials that he would move its base of operations from Beirut to an airfield in Western Europe for the duration of hostilities. He insists, however, that TMA would return to Beirut as soon as the shooting stopped. [redacted] 25X1

Restoring Full Government Control

Restoration of firm central government authority throughout Lebanon would be the best of all worlds from an economic standpoint, though it is unlikely to occur. In our judgment, confidence in a secure future would induce Lebanon's wealthy private sector and foreign investors to rebuild rapidly and take advantage of Lebanon's highly-skilled workforce, sophisticated banking system, and convenient location at the edge of the European and Arab worlds. As long as Beirut avoided large-scale trade and a formal peace treaty with Israel, we believe that harsh Arab economic sanctions would be averted and some small-scale Arab aid likely would be forthcoming. [redacted] 25X1

The intense desire to remain in Lebanon voiced to US officials by the owner of TMA is widely shared among Lebanese businessmen, and in past intervals of peace they have followed through on their commitment to return to and rebuild in Lebanon. Their evident attachment to Lebanon is a primary reason for our belief that should peace and stability return to Lebanon, economic revival would follow swiftly. [redacted] 25X1

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As political and military problems became somewhat less urgent, Gemayel would focus more attention on rebuilding Lebanon's heavily damaged infrastructure. The CDR has drawn up an extensive list of proposed rebuilding projects, funding for which would likely be forthcoming from the Treasury if the government could restore its control and security to all Lebanon. [redacted] 25X1

We do not believe, however, that Beirut would ever regain its pre-civil war status as the preeminent banking, service, and transit center in the Middle East. In the eight years since the outbreak of civil war in Lebanon, other banking centers in Amman, Bahrain, and Kuwait have emerged and rapidly gained experience by handling the huge financial flows resulting from the oil price explosions of the 1970s. Other regional entrepots such as Jordan's port of Aqaba have expanded to handle the reexport trade that once was routed almost exclusively through Beirut. Thus, even if the security problems that currently preclude Lebanon's revival are solved, Beirut would hold a much smaller share of Arab markets than it did before 1975. [redacted] 25X1

Implications for the United States

President Gemayel may appeal to the US to pressure Israel into cutting back its exports to Lebanon, eliminating Lebanese access to Haifa and easing restrictions in the south. [redacted] 25X1

Gemayel will probably increase pressure for substantial US economic aid to his government if Lebanon is partitioned on a semi-permanent basis, pleading absence of Arab aid, low economic activity, and private sector unwillingness to invest. Although current US economic aid can ameliorate living conditions in and around Beirut--the wealthiest part of Lebanon--it cannot spark a general economic revival. The primary impact of US economic aid would be to symbolize a US commitment to the government in Beirut. [redacted] 25X1

If peace and stability did break out, the Lebanese have the funds and the entrepreneurial ability to rebuild their country with little concessional foreign assistance. If and when the government could enforce security throughout its territory, Lebanon would offer profitable business opportunities for US construction companies, banks, hotels, and other service industries. [redacted] 25X1

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APPENDIX

Impact of Eight Years of Fighting

The eight years of more or less constant fighting that erupted with the civil war of 1975 have severely disrupted Lebanon's prosperous and wealthy domestic economy (see chart below). By the time the civil war ended in 1976, real GDP had tumbled to just a third of its 1974 record. During the relative calm of 1977, the economy rebounded to nearly three-quarters of its 1974 level, only to sink again the next year when Israel first invaded the south. The second Israeli invasion of 1982 aborted a vigorous recovery that began after resolution of the Syrian missile crisis in 1981. We estimate that this year GDP will reach less than half 1974 output, and the number of people employed in industry will be less than a third of prewar totals. 25X1

The only growth industry since the civil war has been labor exports; the number of Lebanese working elsewhere in the world more than tripled between 1974 and 1981, and the earnings they sent back home may have reached $2.5 billion in 1981, thereby compensating for much of the decline in personal income caused by the destruction of the domestic economy. 25X1

Changes in Composition of GDP, 1974-80

millions of Lebanese pounds at 1974 prices,
IMF estimates

Sector	1974	1980
Agriculture	758	442
Industry, Water, Electricity	1,449	765
Construction, Transportation	1,002	637
Trade and other services	4,928	3,061
Gross Domestic Product	8,137	4,905

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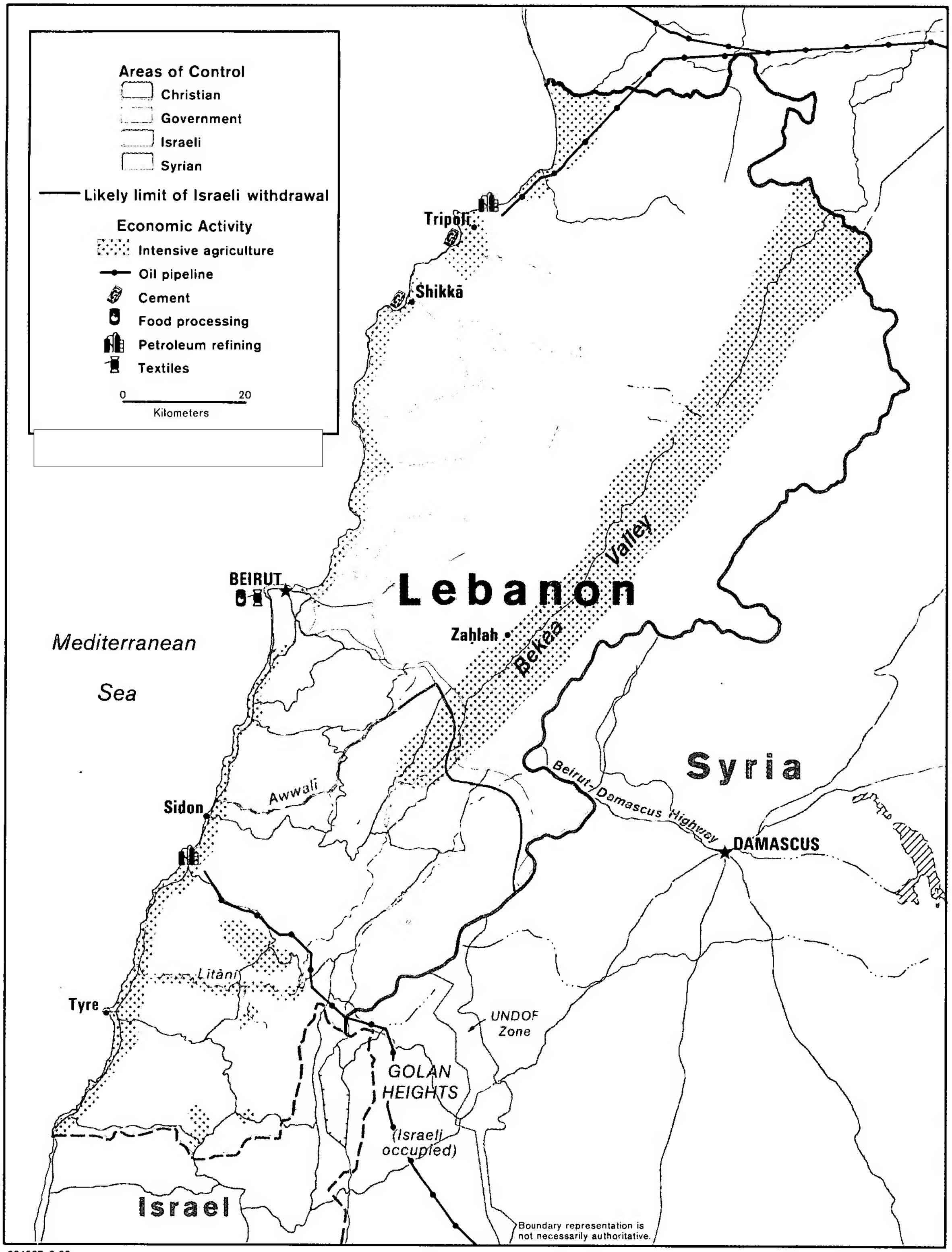

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